What would and would not be taxed?

In theory, everything would be taxed. In practice, there would be great pressure to narrow the base.

Under a pure national retail sales tax, all consumption expenditures by individuals and by federal, state, and local government agencies would be subject to the tax. (Purchases by businesses are, by definition, not retail sales and would not be subject to tax.) However, no sales tax in history has come close to this ideal. Some items, such as imputed financial services, are quite difficult to tax. Taxing others, such as child care, rent, food, housing, and health care, might undermine popular (and arguably desirable) social policies.

The experience of the states demonstrates that interest groups often succeed in carving out preferences, just as they do from the income tax. As a result, few existing state sales levies tax many of the items listed above, and none tax all of them. Hence, there is no precedent for a pure broad-based national retail sales tax.

However, the path of least political resistance—exempting selected sectors—would be problematic. The broader the tax base, the lower the tax rate can be and still reach the revenue target. But health, food, and housing make up more than 40 percent of all personal consumption; exempting even one of these sectors would cut deeply into the sales tax base, forcing the required rate higher. Moreover, even with a very broad base, the required tax rate would have to be very high to replace existing federal taxes.

Consider, too, that a national retail sales tax would need to tax all purchases by state and local governments. Exempting them would narrow the base substantially, which in turn would raise the tax rate needed to generate a given amount of revenue. Taxation of government transactions would also be necessary to ensure that private industry is not placed at a disadvantage when competing with public suppliers of goods and services.

Although the details of various national retail sales tax proposals vary, they generally maintain similar tax-base characteristics. Exemptions would be provided for business purchases and education, both of which are considered investments. Domestic purchases by foreigners would be taxed; foreign purchases by US residents would not.

Employer-provided health insurance would be taxed, but economists Jonathan Gruber and James Poterba estimate that this tax change would boost the price of health

insurance by an average of 21 percent. This price increase would reduce both the number of people insured (by 6 million to 14 million) and the amount of insurance that each remaining insured person would choose to carry.

The existing deductions for mortgage interest and property taxes would disappear with the income tax. This would reduce the value of all residential housing. Newly constructed houses sold to occupants would be subject to the sales tax, but existing houses would generally not since such transactions would not constitute retail (business-to-household) sales. This change would lower the market value of new houses relative to old ones.

FURTHER READING

Gale, William G. 2005. "The National Retail Sales Tax; What Would the Rate Have to Be?" *Tax Notes* 107 (7): 889–991.

Gruber, Jonathan, and James Poterba. 1996. "The Impact of Fundamental Tax Reform on Employer-Provided Health Insurance." *Insurance Tax Review* 11 (1): 41–44.

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